South Carolina Department of Consumer Affairs

The Savvy Consumer's Guide to

INSURANCE SCORING

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In the past, credit scoring systems have been used to assess credit worthiness for credit cards, automobile loans and home mortgage loans. Insurers have been allowed to use credit histories when deciding to offer coverage, renew an existing policy, offer a preferred rate or place with a nonstandard insurer since 1970, when Congress passed the Fair Credit Reporting Act, which permits the use of credit reports for insurance purposes. Insurance scoring is an evolving technique among insurers. The trend burgeoned among insurers in 1998.

The terms credit scores and insurance scores are often used interchangeably when referring to insurer use of credit information, but insurance scores are different from credit scores. Industry insiders are closemouthed on the specifics of insurance scoring, but some information is known about them. Insurance scores and credit scores look at the same five characteristics of a person's credit history — Payment History, Outstanding Debt, Length of Credit History, Recent Inquiries on Credit Report and Types of Credit in Use — but the scores are developed differently and different weights are given to specific, undisclosed credit report information. The scores also predict different outcomes. Credit scores predict the likelihood of delinquency on a credit account. Insurance scores predict future insurance losses by examining patterns of financial responsibility.

The most significant difference between insurance scores and credit scores is that insurance scores look for stability. *"It's not whether you're going to be able to pay an insurance premium, it's actually the number of losses you're predicted to have,"* says Carole Walker, of the Insurance Information Association. Insurance scores are more interested in how regularly you pay, instead of how much you already owe. Insurers use credit information to try to identify consumers who are consistent and reliable, as well as those who show a pattern demonstrating common sense with money. Insurance scores are used for automobile, homeowners and renter's insurance.

Insurance Scoring in Personal Automobile Insurance: Breaking the Silence, a 2001 survey of the 100 largest personal automobile insurers, found that 92 percent of the insurers use insurance scoring for new business underwriting. Slightly more than half of the respondents reported using scoring in their underwriting and pricing decisions and 38 percent to classify applicants for preferred, standard or nonstandard programs. Nearly all of the survey respondents say they use the scores for new business only. However, some companies have also started using insurance scores to non-renew coverage, regardless of whether a claim has been filed or premiums have been paid on time.

In some cases, insurers believed that a consumer's credit rating, i.e., insurance risk score, may be more important than his/her driving record. In fact, a consumer who may have paid every insurance bill on time and never filed an insurance claim, could still have a bad insurance score. That bad score could make the consumer pay significantly more for insurance, or prevent an insurance company from offering the consumer coverage.

Insurers may use their own scoring systems, different scoring models for different types of insurance or a generic model developed by a scoring company. Allstate Insurance Co. and State Farm Mutual Auto Insurance Co., the nation's two largest auto and home insurers, have developed their own insurance risk scoring systems that incorporate credit information.

The principal information-gathering companies insurers use to assist them in their underwriting decisions are ChoicePoint and Insurance Services Offices, Inc., (ISO). ChoicePoint is part of the Equifax credit reporting agency. It uses a secret, Fair, Isaac & Company scoring formula to maintain a database called CLUE — Comprehensive Loss Underwriting Exchange. The database contains your name, address, telephone number, credit report, claims history and motor vehicle report. ChoicePoint also compiles aliases, criminal records and histories of vehicles. The company uses the information for credit scoring, claims history reporting and driving-record reporting.

When a consumer fills out a new automobile insurance application, the potential insurer queries ChoicePoint for a credit score and claims history. ChoicePoint caters to nearly all property and casualty insurers. The company makes their consumer profiles available to consumers for $8 to $10, depending on the format the requester desires. Call the ChoicePoint Consumer Disclosure Center, 770.752.6000.

The ISO maintains databases called the All Claims databases. These databases contain information about any of your claims that might have ended up in court. The company says it uses the databases solely for detecting fraud and expediting the claims process. For example, if ISO detects a series of claims with the same name on all of the claims, but with different social security numbers, it will notify the insurance company and the insurer will investigate. Consumers can obtain a copy of their ISO report, called the Auto Property Loss Underwriting Service (A-Plus), if they dispute the information it contains, by calling 800.709.8842. Consumers must also complete a Request for Disclosure form.

Proponents of insurance scoring say that there is a direct correlation between future claims history and insurance scores.

☞ They claim people who have better credit — as least as reflected in their insurance scores — file fewer claims, thus costing the insurer less money.

> The 2001 study found that consumers with insurance scores in the bottom 20 percent filed approximately 40 percent more claims than consumers in the top 20 percent.

☞ Advocates of insurance scoring say it treats all applicants objectively and is more reliable since it is based on real data and statistics.

They contend that using automated underwriting decisions based on objective data like insurance scores removes the potential for human bias.

☞ Supporters allege that including insurance scores as part of a driver's overall risk profile allows insurers to underwrite and price policies more efficiently, accurately and consistently.

☞ They hold that insurance scoring allows insurers to accept many applicants they would have rejected in the past — leading to a more competitive marketplace for consumers.

☞ They argue that approximately 75 percent of adult consumers have good credit. Therefore, consumers should not think that their insurance scores will be used against them to increase their premiums.

☞ They maintain that insurance scores help to ensure that prices are distributed equitably across risk classifications. Financially responsible individuals are not penalized through premium subsidization.

☞ The practice, they insist, is revenue neutral. The premium reductions received by those with the best insurance scores offset the increases given to those with the worst scores.

☞ Several of the large insurance companies have tracked their experience with insurance scores and state unequivocally that the majority of their policyholders receive lower rates as a result of scoring.

Opponents of insurance scoring counter that the practice is unfair because it penalizes consumers for events outside of their control.

☞ They cite the victims — direct and indirect — of the September 11, terrorist attacks. Should they pay higher automobile or homeowner's insurance premiums?

☞ They point to consumers with high medical bills from an unforseen illness or other medical catastrophe.

☞ Unemployed consumers, victims of economic recessions or other unforseen economic catastrophe.

☞ Consumers under the financial impacts of divorce.

☞ Consumers with little or no credit history, who do not take loans, and have minimal utilization of credit cards.

☞ They point out that there has not been an independent analysis of the alleged correlation between future claims history and insurance risk scores. —

The only entities with access to insurance data and consumer credit information are the scoring vendors and insurers.

☞ “They haven’t verified that minorities, people with disabilities and the poor aren’t discriminated against by these systems,” says J. Robert Hunter, director of insurance for the Consumer Federation of America.

☞ There has been no independent verification that the elderly are not discriminated against by these systems.

☞ Moreover, adversaries of the practice assert the industry has not educated consumers about how the process works. Consumers need to be informed about why and when credit is used in the application process.

The Fair Credit Reporting Act calls for insurers to inform applicants if credit information is used to determine their premiums or eligibility for insurance. If an applicant is denied insurance or pays more for it because of insurance scoring, the insurer must provide a toll-free number to the consumer to allow them to request a copy of their credit report. The consumer has ONE MONTH to request this information after receiving the notice. Scoring models cannot consider address, age, ethnic group, gender, marital status, military rank, nationality or religion.

Consumers who think that their credit history played a role in denied coverage or higher premiums should:

☞ Ask the insurance company if it uses credit scores as a determining factor.

☞ Obtain a copy of your credit report.

When the report arrives, make sure it is accurate. If you find a mistake, ask for a correction form from the credit bureau. By law, the credit bureau must respond to your request within 30 days.

☞ If you have been denied insurance, appeal.

Ask the insurance company to put the reason(s) in writing.

If you have a low insurance score, take action! You may improve your score by:

☞ Paying bills on time.

☞ Updating old accounts.

☞ Establishing credit.
If you don't qualify for a credit card, get a gas station card or a secured credit card from a reputable source, such as a bank, and use it to build a history.

☞ Carrying a low balance and paying it off may help provide a history of handling debt responsibly.

☞ Keeping current to raise your score. Don't max out your credit lines.
Twelve months is usually needed to prove that credit problems are in the past.

☞ Limiting the number of times you apply for credit.
Don't open new, unnecessary accounts just to build credit. Open accounts you can use regularly and responsibly.

☞ Maintaining accounts for a long period of time.

☞ Staying away from finance companies.